Saskatchewan

Rate Review Panel

Report to the Minister of Crown Investments Corporation on:

The Proposal from SaskEnergy for a Change in the Gas Consumption Rate

June 1, 2001

Saskatchewan

Rate Review Panel

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Saskatoon

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Economist, Vice Chair
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Assiniboia

Sheldon Craig
La Ronge

Joan Meyer
Swift Current

June 1, 2001

Honourable Maynard Sonntag
Minister of Crown Investments Corporation
Room 38, Legislative Building
Regina, Saskatchewan S4S 0B3

Dear Minister:

As instructed in the Minister's Order dated May 1, 2001, we have completed our review of the SaskEnergy proposal for changes in the gas consumption rate. We are enclosing our Report for your consideration.

In conducting our review, we received advice from a variety of interested parties and the general public through meetings and submissions received through the mail, by facsimile, by telephone and through electronic mail systems. We also engaged the services of a consultant to provide expert analysis and advice.

We received excellent co-operation from SaskEnergy officials who responded to the consultant's and our requests for additional information in a professional and timely manner.

We are satisfied that our recommendations are fair and reasonable considering the interests of the customer, the Crown corporation and the public.

We thank you for this opportunity to provide you our recommendations and the outcome of our deliberations.

Sincerely,

Bob Lacoursiere, CA, CMC, RFP
Chair

Attachment (1)

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102-02308/

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to the Saskatchewan Rate Review Panel

Introduction

The Saskatchewan Rate Review Panel (the "Panel") has been asked by the Government of Saskatchewan to review Crown corporations' requests for rate changes for SaskEnergy, SaskPower and SGI - AutoFund.

The Panel consists of Bob Lacoursiere (Chair), Jack Boan (Vice Chair), Tracey Bakkeli, Jo-Ann Carignan-Vallee, Sheldon Craig and Joan Meyer. Each member of the Panel has been appointed until July 25, 2002.

MANDATE

In its general mandate, the Panel is instructed to conduct reviews and provide opinions on the fairness and reasonableness of proposed Crown corporation rate changes referred by the Minister of Crown Investments Corporation, considering the interests of the customer, the corporation and the public.

In conducting its reviews, the Panel is required to:

- receive a rate change submission from a Crown corporation;
- establish procedures for conducting the review and ensure that these procedures are made available to the public;
- engage the services of a consultant(s) to assist the Panel in its review of the fairness and reasonableness of the proposed rate change;
- make available to the public, prior to holding public meetings, the Crown corporation rate change submission, with the exception of commercially sensitive information;
- hold public meetings and provide appropriate notification to the public of the date and location of public meetings, including any rules for public participation and Crown corporation participation;
- provide members of the public with the opportunity to review and comment on the proposed rate changes to the extent reasonably allowed by the mandate of the Panel and by the schedule according to which the Panel is required to complete its work and provide its report to the Minister of Crown Investments Corporation;
- receive presentations of the consultant(s) or the Crown corporation, review any written submissions and receive comments from the public;
- prepare a report on the Crown corporation rate change submission for the Minister of Crown Investments Corporation after considering the material received from the Crown corporation, the consultant(s), the public and its own analysis:
    - where the Panel determines the rate changes as proposed are fair and reasonable, recommend that the changes be implemented; or,
    - where the Panel determines the rate changes are not fair and reasonable as proposed, recommend that the rate changes be adjusted providing reasons for this conclusion;

- provide its report respecting the proposed rate changes to the Minister of Crown Investments Corporation on a date set out in or within any time period after having received the rate change submission that is contained in the specific terms of reference for particular Crown corporation rate reviews; and,
- make its report available to the public.

TERMS OF REFERENCE

On May 1, 2001, the Panel was instructed to conduct a review of the SaskEnergy proposal for a change in the gas consumption rate.

With respect to the proposal for the gas consumption rate, the Panel was instructed to consider the reasonableness of the proposed change in the context of:

- SaskEnergy's anticipated cost of gas for the effective term;
- the Gas Purchase Contracts entered into by SaskEnergy for the supply of gas;
- the amount SaskEnergy pays for the transportation of gas;
- the natural gas commodity market conditions at the time of SaskEnergy's contractual commitments; and,
- the disposition of the balance of the Gas Cost Variance Account.

In reviewing the proposal, the Panel was instructed to take as given:

- the current operating rate structure;
- the approved capital allocation, annual rate of return target, rate base, and corporate policies;
- the existing service level; and
- the cost of service methodology and resulting study, which allocates SaskEnergy costs between the various rate classes.

The Panel was instructed to present its report to the Minister of Crown Investments Corporation by June 1, 2001 (see Appendix A).

Proposal by SaskEnergy – Gas Consumption Rate

The SaskEnergy proposal is for a change in the gas consumption rate.

GAS CONSUMPTION RATE

SaskEnergy charges customers for the cost of natural gas used. This charge appears separately on a customer's bill and was established at a rate of 16.69 cents per cubic metre effective December 1, 2000.

The SaskEnergy proposal is to increase this rate to 28.26 cents per cubic metre to:

- reflect dramatic increases in the cost of natural gas in the North American market in the past year; and
- reduce the deficit in the Gas Cost Variance Account (GCVA).

Under the SaskEnergy proposal, the new rate would apply to natural gas effective June 1, 2001. SaskEnergy did not request any changes to either the Basic Monthly or Delivery Charges.

SaskEnergy Application
Impact of Gas Consumption Charge of 28.26 cents per cubic metre
Effective June 1, 2001*

Rate Class	Average Monthly Bill Impact**	Small Usage Bill Impact **	Large Usage Bill Impact **
Residential	$33 (42%)	$19 (38%)	$51 (44%)
Farm	$41 (43%)	$27 (40%)	$58 (44%)
General Service II	$135 (47%)	$48 (43%)	$771 (50%)
General Service III	$1,903 (52%)	$964 (51%)	$6,364 (52%)

* **Excludes Municipal Payments and GST charges.**

** **Percentage impact calculated on total of basic, delivery (volume based) and gas consumption charges.**

The Review Process

PUBLIC CONSULTATIONS

In reviewing the SaskEnergy proposal, the Panel received comments and suggestions from individuals and groups throughout Saskatchewan through a public consultation process including:

- four public meetings;
- use of a toll-free telephone message line;
- receipt of three (3) formal submissions from the Saskatchewan Association of Rural Municipalities (SARM), Saskatchewan Recreation Facilities Association (SRFA) and CEG Energy Options Inc.;
- receipt of submissions by mail;
- receipt of messages by facsimile; and,
- receipt of electronic message correspondence.

The methods available for public discussion were advertised in daily newspapers and in weekly newspapers. In addition, clips were played on local radio stations.

Panel members were also involved in various media interviews and public appearances.

A copy of the SaskEnergy rate proposal was available to the public at SaskEnergy offices, at the public meetings and on the Internet.

The four public meetings were held on:

- May 14 at the Banquet and Convention Centre in Prince Albert;
- May 15 at the Saskatoon Inn in Saskatoon;
- May 16 at the Regina Inn in Regina; and
- May 17 at the SIAST Palliser Campus in Moose Jaw.

The meetings included:

- an introduction by the Chair with an explanation of the proceedings and the Panel's mandate for the review;
- an overview by SaskEnergy of its request;
- an opportunity for submissions by individuals or organizations that had indicated an interest in addressing the Panel; and,
- an opportunity for questions or comments from the floor.

CONSULTANT

In conducting its review, the Panel engaged the services of a consultant to examine and advise on the reasonableness and fairness of the SaskEnergy proposal.

The British Columbia Utilities Commission (BCUC) was contracted to provide consulting services to the Panel. Staff assigned to the review by the Commission have extensive experience in utilities regulation. They have served as consultants on SaskEnergy rate applications to both the current Panel in 2000, as well as to the Saskatchewan Interim Rate Review Panel in 1999.

PRESENTATIONS

As required in its mandate, the Panel received presentations and information from officials of SaskEnergy and from its consultant at several points throughout the review process to:

- develop an understanding of the proposed rate change;
- understand the analyses prepared for the Panel; and,
- develop its recommendations.

PANEL'S REVIEW

The Panel commends those who made the effort to share their views, concerns and suggestions through the public input process within a very short time. The Panel also commends SaskEnergy staff for their professionalism, co-operation and responsiveness within very tight timelines.

The Panel has prepared this report highlighting the results of its consultation process, analysis and recommendations to the Minister of Crown Investments Corporation.

Summary of Consultant's Report

The Panel met with the consultant and subsequently sought additional information from SaskEnergy officials on the rate proposal.

The consultant also provided briefings to the Panel on specific issues and prepared a final report and assessment of the SaskEnergy submission (attached as Appendix B).

GAS COST VARIANCE ACCOUNT

Background

In 1999-2000, SaskEnergy introduced the use of a **Gas Cost Variance Account (GCVA)**. The GCVA is used to ensure SaskEnergy does not earn a profit nor incur a loss on the supply of gas.

For example, if the rate established for natural gas consumption proves to be higher than the actual cost to SaskEnergy to purchase gas in the course of a year, the 'surplus' would accrue in the Gas Cost Variance Account and could be applied to reduce the gas consumption rate from the level it would otherwise be in subsequent periods.

Conversely, if the gas consumption charge in any gas year is inadequate to cover the actual cost of gas purchased in that year, the 'deficit' in the Gas Cost Variance Account would be added into the calculation of gas consumption charges in subsequent periods.

The consultant's report indicates the projected deficit in the GCVA will be approximately $80.2 million as of May 31, 2001.

Amortization Period for the Gas Cost Variance Account

According to the consultant's report to the Panel, SaskEnergy appears to be administering the GCVA generally as expected. The consultant noted the relatively large deficit of $80.2 million is of concern but appears to be manageable if addressed over a reasonable period of time. The consultant also noted given the continued volatility of gas prices it would be appropriate for the Panel to conduct a more frequent review of the GCVA balance, perhaps on a quarterly basis.

The consultant considered SaskEnergy's rate request, which anticipated a $30.4 million GCVA deficit by October 31, 2002, to be roughly equivalent to a two-year amortization period. The consultant noted a shorter amortization period increases the impact of the already large commodity cost rate increase while a longer amortization period has limited benefits. Neither of these approaches is considered in the best interests of the customer.

On this basis the consultant recommended the Panel accept the amortization proposed by SaskEnergy as reasonable. In addition, the consultant recommended the GCVA interest costs would be more properly allocated to the GCVA balance recovery rather than to the cost of gas calculation.

Gas Cost Variance Account Interest

Deficit balances in the GCVA are charged interest at SaskEnergy's short-term borrowing rate. In contrast, SaskEnergy proposed surplus balances (in favour of the customer) would earn interest at a short-term investment rate. The consultant notes while the differences between these approaches are likely to be minimal, for simplicity it would be preferable to use the same rate in both instances. The consultant recommended the use of the short-term borrowing rate.

Gas Cost Variance Account Recovery Fee

The consultant noted all SaskEnergy customers who benefited from the lower rates associated with the creation of the GCVA deficit from December 1, 2000 to May 31, 2001 share responsibility for its repayment.

Given all of the above, the consultant therefore recommended implementing a 'Gas Rate Rider' (or GCVA Recovery Fee) of $0.0262 per cubic metre, effective June 1, 2001.

FORECAST COST OF GAS/GAS CONSUMPTION CHARGE

The consultant noted there has been a significant and rapid increase in natural gas commodity prices in North America in the last two years primarily as a result of strong demand growth from the United States combined with a limited supply. The consultant also noted forecast increases are largely beyond the control of SaskEnergy and stated:

> "The Utility has done an efficient job of mitigating the exposure of customer to higher prices during this period of high North American demand and constrained production capability." (See consultant's report, Appendix B, page 15)

The consultant noted prices continue to be volatile and believes most of SaskEnergy's gas costs to be reasonable, but suggests three modifications.

At the time of SaskEnergy's application, the forecasted cost of gas through the period ending October 2002 was in the $7.00/GigaJoule (GJ) range and based on a 'worst case' scenario. In the interim, prices dropped to the $6.00/GJ range by May 10, 2001 and the consultant consequently requested SaskEnergy prepare a forecast on this basis. This new rate results in a $17.7 million reduction in the estimate for the cost of gas sold (See consultant's report, Appendix B).

In addition, the consultant noted SaskEnergy has sold some put options for the 2001/02 gas year and it anticipates further sales in this regard. SaskEnergy did not consider the forecasted revenue from additional put option sales in its calculations, therefore the consultant suggests $12 million of this estimate be included.

The consultant noted due to a trend of declining use per residential customer, it would be more appropriate to use a volume of 2,015,316 thousands of cubic metres rather than 2,046,821 thousands of cubic metres SaskEnergy included in its application.

Using the reduced cost of gas forecast, incremental revenue from put options, reallocated GCVA interest costs and reduced load forecasts, the consultant recommends a gas consumption charge of $0.2439 per cubic metre.

Combining the GCVA Recovery Fee of $0.0262 and the Gas Consumption Charge of $0.2439, results in a total Gas Consumption fee of $0.2701 per cubic metre.

Panel Conclusions and Recommendations

GAS COST VARIANCE ACCOUNT (GCVA)

Regular Reporting

The Panel noted because of the unprecedented high prices and volatility of the natural gas market in the past months the GCVA accumulated a significant deficit within a very short timeframe. Many of the contributing circumstances were outside of SaskEnergy's control. The Panel notes these rapid changes should be addressed by frequent reviews of the GCVA balance.

The Panel recommends SaskEnergy submit a quarterly report of the GCVA balance to the Panel.

The Panel noted a detailed audit and report of the costs and revenues assigned to the GCVA was not practical for the purposes of this review. However, it does feel an in-depth analysis would be beneficial for future deliberations.

The Panel considered a range of options for the most appropriate mechanism whereby this audit could be undertaken, including SaskEnergy's internal audit group, SaskEnergy's external auditor or the Provincial Auditor (or designate). The Panel wishes to obtain a fully independent view of the cost assignments to the GCVA.

The Panel recommends the Provincial Auditor (or designate) undertake an audit of the costs and revenues assigned to the GCVA for the gas year ending October 31, 2001 and then annually thereafter. The audit report is to be provided directly to the Panel no later than December 31 each year.

Amortization Period for the Gas Cost Variance Account

The panel considered a range of options for an appropriate amortization period for the GCVA deficit.

A shorter (eg. one year) amortization period would exacerbate an already significant rate increase. A longer (three or four year) amortization period marginally reduces the amount required as an add-on but increases the interest costs that the customer must ultimately bear. The Panel determined a 24-month amortization period would balance the interests of customers, SaskEnergy and the public.

The Panel recommends adopting a target of 24 months to eliminate the deficit in the GCVA.

Gas Cost Variance Account Interest Calculation

The Panel noted the consultant's assessment of the alternatives for assessing interest earned on a surplus balance in the GCVA. The Panel agrees with the consultant that it would be preferable to use the same rate as when calculating interest on a deficit balance.

The Panel recommends SaskEnergy use their short-term borrowing rate for calculating interest on GCVA balances in all cases.

Gas Cost Variance Account Recovery Fee

The Panel acknowledges SaskEnergy must take steps to promptly address the deficit in the GCVA. It is hoped with the 24-month target amortization period the deficit can be reduced to acceptable levels and a recovery fee would then no longer be necessary.

The Panel noted SaskEnergy's commodity customers have benefited through a lower than actual cost of gas by the accrual of the $80.2 million deficit to the GCVA. The Panel notes all customers who benefited from the lower than actual cost should retain the responsibility for the repayment of this deficit.

The Panel notes new customers will also be required to pay GCVA Recovery Fee. However, a two-tiered pricing system would be inappropriate.

The Panel recommends a GCVA Recovery Fee of $0.0262 per cubic metre be implemented effective June 1, 2001 for all SaskEnergy commodity customers and it be maintained until the deficit is eliminated.

COST OF GAS/GAS CONSUMPTION CHARGES

SaskEnergy requested an increase in the gas consumption rate to reflect forecasted commodity costs and, at the same time, to reduce the deficit in the GCVA from $80.2 million to a projected $30.4 million. The proposed increase was from the current rate of $0.1669 per cubic metre to $0.2826 per cubic metre, or a 69% increase, effective June 1, 2001 to October 31, 2002.

SaskEnergy's rate change request was based on its assessment of a worst-case scenario. The Panel believes a forecast on a 'most likely' scenario should be used to determine the rate change. The Panel notes a further increase in the GCVA is undesirable but expedited quarterly reviews will allow more timely actions to be taken should a 'worst case' scenario materialize.

As noted by the consultant, SaskEnergy has earned some revenue from put option sales in the past. Therefore, the Panel believes $12 million of forecasted put option revenues should be included in the calculations of the cost of gas.

The Panel recommends a gas consumption charge of $0.2439 per cubic metre effective June 1, 2001.

The combined Gas Consumption Charge ($0.2439) and the GCVA Recovery Fee ($0.0262) result in an effective rate of $0.2701 per cubic metre as of June 1, 2001.

Summary

PANEL RECOMMENDATIONS

1. SaskEnergy submit a quarterly report of the GCVA balance to the Panel.

2. The Provincial Auditor (or designate) undertake an audit of the costs and revenues assigned to the GCVA for the gas year ending October 31, 2001 and then annually thereafter. The audit report is to be provided directly to the Panel no later than December 31 each year.

3. Adopt a target of 24 months to eliminate the deficit in the GCVA.

4. SaskEnergy use their short-term borrowing rate in calculating interest on GCVA balances in all cases.

5. A GCVA Recovery Fee of $0.0262 per cubic metre be implemented effective June 1, 2001 for all SaskEnergy commodity customers and be maintained until the deficit is eliminated.

6. A Gas Consumption Charge of $0.2439 per cubic metre be implemented effective June 1, 2001. The combined Gas Consumption Charge ($0.2439) and the GCVA Recovery Fee ($0.0262) result in an effective rate of $0.2701 per cubic metre effective June 1, 2001.

IMPACT ON CUSTOMERS

The Gas Consumption Charge of $0.2439 per cubic metre plus the GCVA Recovery Fee of $0.0262/cubic metre results in a total charge of $0.2701/cubic metre to every customer. This is an effective rate increase of 61.8%. While actual increases will depend on the amount of gas used, the increase for an average residential customer will be approximately $356 per year, **excluding** Municipal Payments and GST.

Summary Comparison of Current, Requested and Recommended Gas Consumption Charge Rates (per cubic metre)

	Current	Requested	Recommended
Gas Consumption	$0.1669	$0.2826	$0.2439
GCVA Recovery Fee	-	-	$0.0262
Total Gas Rate	$0.1669	$0.2826	$0.2701

Customer Impact – Current and Recommended

Rate Class	Basic Monthly Charge	Delivery Charge	Gas Consumption Charge
Residential - Current	$10.50	$0.0710 per m^3	$0.1669 per m^3
Residential - Recommended	$10.50	$0.0710 per m^3	**$0.2701 per m^3**
Farm - Current	$11.55	$0.0710 per m^3	$0.1669 per m^3
Farm - Recommended	$11.55	$0.0710 per m^3	**$0.2701 per m^3**
General Service II - Current	$17.00	$0.0631 per m^3	$0.1669 per m^3
General Service II - Recommended	$17.00	$0.0631 per m^3	**$0.2701 per m^3**
General Service III - Current	$37.25	$0.0551 per m^3	$0.1669 per m^3
General Service III - Recommended	$37.25	$0.0551 per m^3	**$0.2701 per m^3**

Note: per m^3 = per cubic metre

The Panel recognizes this modified rate will still have a significant impact on all users as illustrated below.

	Average Monthly Bill				
	Volume of Gas Used*	Total SE Charges**	Municipal Payment+	GST	Total Bill ++
Small Volume Residential - Current	167	$50.15	$2.51	$3.69	$56.34
Small Vol. Resid. - Recommended	167	$67.35	$3.37	$4.95	$75.67
Average Vol. Resid. - Current	288	$78.96	$3.95	$5.80	$88.71
Average Vol. Resid. - Recommended	288	$108.65	$5.43	$7.99	$122.07
Large Vol. Resid. - Current	438	$114.58	$5.73	$8.42	$128.73
Large Vol. Resid. - Recommended	438	$159.73	$7.99	$11.74	$179.46
Farm (Average) - Current	355	$95.92	-	$6.71	$102.64
Farm (Ave) - Recommended	355	$132.47	-	$9.27	$141.74
General Service II (Ave) - Current	1164	$284.74	$14.24	$20.93	$319.90
General Service II (Ave) - Recommended	1164	$404.87	$20.24	$29.76	$454.87
General Service III (Ave) - Current	16450	$3,689.37	$184.47	$271.17	$4,145.01
General Service III (Ave) - Recommended	16450	$5,386.87	$269.34	$395.94	$6,052.15

* Cubic metres per month (average)

** Total SE Charges = Basic Monthly and Delivery and Gas Consumption Charges.

\+ Municipal payments are 5% of sales for 11 cities and 85 towns. A 3% municipal payment is applicable in 13 towns. All other town, villages, hamlets, resorts and rural areas have no municipal payments. For the purposes of this calculation, a municipal payment of 5% on sales is assessed for all Rate Classes **except** Farm.

++ Numbers may not balance precisely due to rounding.

IMPACT ON SASKENERGY

With this rate change the GCVA deficit is targeted to be amortized over 24 months reducing SaskEnergy's borrowing requirements related to its responsibilities to supply gas.

This rate increase also recognizes the increased cost of gas and passes it on to the customers who will be using the gas.

IMPACT ON THE PUBLIC

The rate change recommended by the Panel:

- recognizes the volatility of natural gas prices in North American markets;
- addresses the deficit in the GCVA; and
- increases revenue to the municipalities who collect the Municipal Payment.

It is the Panel's view the rate change recommended is fair and reasonable, considering the interests of the customer, the Crown corporation and the public.

Appendix A:
Minister's Order
SaskEnergy Gas Consumption Rate Change

MINISTER'S ORDER

Saskatchewan Rate Review Panel
SaskEnergy Gas Consumption Rate Change

WHEREAS by a Minister's Order dated July 27, 2000, issued pursuant to section 16 of *The Government Organization Act*, the Minister of Crown Investments Corporation appointed a ministerial advisory committee known as the Saskatchewan Rate Review Panel.

WHEREAS that Minister's Order provides for specific terms of reference for particular Crown corporation rate change reviews to be attached by further minister's order.

WHEREAS it is desirable to establish terms of reference for a SaskEnergy gas consumption rate change review and to attach the terms of reference to the previously mentioned Minister's Order.

NOW THEREFORE I hereby amend the said Minister's Order by attaching Appendix A affixed hereto as **"Schedule E: SaskEnergy Gas Consumption Rate Change Terms of Reference"** to the said Minister's Order.

Dated at the City of Regina, Saskatchewan, this 1st day of May, 2001.

Maynard Sonntag
Minister of Crown Investments Corporation

APPENDIX A

Schedule E:
SaskEnergy Gas Consumption Rate Change Terms of Reference

Terms of Reference

The Saskatchewan Rate Review Panel is requested to conduct a review of SaskEnergy's request for an increase in its gas consumption rates for the term June 1, 2001, to October 31, 2002.

The Panel shall provide an opinion of the fairness and reasonableness of SaskEnergy's proposed rate changes, considering the interests of the customer, the Crown corporation and the public.

In conducting its review, the Panel will consider the following factors:

The reasonableness of the proposed changes to the gas consumption rates in the context of:

1. SaskEnergy's anticipated cost of gas for the effective term;
2. the Gas Purchase Contracts entered into by SaskEnergy for the supply of gas;
3. the amounts SaskEnergy pays for the transportation of gas;
4. the natural gas commodity market conditions at the time of SaskEnergy's contractual commitments; and
5. the disposition of the balance of the Gas Cost Variance Account.

In conducting its review, the Panel shall consider the following as given:

(i) the current operating rate structure;
(ii) the approved capital allocation, annual rate of return target, rate base, and corporate policies;
(iii) the existing service level; and
(iv) the cost of service methodology and resulting study, which allocates SaskEnergy costs between the various rate classes.

The Panel will not publicly release or require SaskEnergy to publicly release commercially sensitive material including, but not limited to, its gas price hedging strategy and any details of its hedging or the gas purchase contracts.

However, the Panel may release the net effect of SaskEnergy's gas price hedging and gas purchase contracts.

Conduct of Review

The Panel will present its report to the Minister of Crown Investments Corporation no later than June 1, 2001.

Appendix B:
British Columbia Utilities Commission Staff Review Report to the Saskatchewan Rate Review Panel

SASKENERGY INCORPORATED

NATURAL GAS DISTRIBUTION UTILITY

COMMODITY RATE APPLICATION

for

June 1, 2001 – October 31, 2002

STAFF REVIEW REPORT

May 28, 2001

Prepared by:

J.B. Williston, Manager, Engineering and Commodity Markets
W.J. Grant, Executive Director

BRITISH COLUMBIA UTILITIES COMMISSION
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ATTACHMENT 3 – The BCUC and BCUC Staff

SASKENERGY INCORPORATED

COMMODITY RATE APPLICATION

JUNE 1, 2001 – OCTOBER 31, 2002

BCUC STAFF REVIEW REPORT

1.0 INTRODUCTION

1.1 SaskEnergy Application

SaskEnergy Incorporated ("SaskEnergy", the "Utility") filed an Application requesting an increase in its Gas Consumption Charge for the 17-month period from June 1, 2001 through October 31, 2002.

In the Application, SaskEnergy requested a 69 percent increase in its Gas Consumption Charge from $0.1669 per cubic metre ($4.50/GJ[1] at 37.10 GJ per thousand cubic metres) to $0.2826 per cubic metre ($7.62/GJ) effective June 1, 2001. The new rate is the forecast cost to SaskEnergy of the natural gas that it will resell to customers, plus recovery of part of the money owed to the Utility due to higher than forecast gas prices since November 2000. The corresponding increase in the annual bill of a typical residential customer would be $400 or 42 percent. Other customer classes would have average annual bill increases of 43 to 52 percent.

The current Gas Consumption Charge went into effect December 1, 2000, and increased a typical residential annual bill by 26 percent.

The rapid rise in natural gas commodity prices over the past two years has been a North American phenomenon resulting from strong demand growth in the United States and limited supply. There are many reasons for the tightness in the natural gas markets including: reduced exploration and drilling activity prior to 1999 when commodity prices were low; new demands for natural gas-fired thermal-electric generation; weather; strong economic growth; and much higher crude oil prices. Consumers have been critical of the cost increases but, for the most part, they recognize that the natural gas commodity is deregulated and market driven, and that gas is a competitive fuel for heating. It is hoped that recent drilling activity and a more moderate growth in the economy will soon bring the natural gas market into equilibrium. This review is to determine if SaskEnergy has entered into prudent contracting plans to ensure that customers receive adequate supplies of natural gas, at as low a price as is available in the competitive market, and to confirm the rates that result from SaskEnergy's gas purchases.

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[1] A Petajoule ("PJ") is one million gigajoules. A terajoule ("TJ") is one thousand gigajoules. A gigajoule ("GJ") is a unit of energy. One GJ is about the amount of energy contained in 27 cubic metres or 950 cubic feet of natural gas, or 29 litres of gasoline, or 278 kilowatt hours of electricity, or 0.16 barrels of oil. The amount of natural gas used by individual residential customers varies widely; a typical residential customer consumes about 130 GJ annually for heating and hot water.

1.2 SaskEnergy and Its Gas Distribution Activities

SaskEnergy is a provincial Crown Corporation operating under the SaskEnergy Act. SaskEnergy has a number of wholly-owned subsidiaries, each operating on a stand-alone basis. One subsidiary is TransGas Limited ("TransGas") which owns and operates natural gas transmission, gathering, compression, treatment and storage facilities in Saskatchewan. TransGas has an exclusive right to transport gas within the province, up to the town border stations where pressure reduction first occurs.

SaskEnergy, as the Distribution Utility, has the exclusive right to distribute gas within Saskatchewan. It delivers gas to approximately 319,000 residential, farm, commercial and industrial customers. Although the facilities of SaskEnergy start at the town border stations, its rates start with gas at the TransGas Energy Pool ("TEP"). TEP is a notional location part way through the TransGas transmission system, which acts as a market hub or interchange point. SaskEnergy contracts with TransGas for gas storage and for transportation capacity from TEP to the SaskEnergy system for its utility sales customers, and also for about 1,000 customers who buy gas directly from other suppliers but use load-shaped and balanced SaskEnergy delivery service. The TransGas transportation and storage costs are recovered from customers in SaskEnergy's Delivery Charges, along with SaskEnergy's costs of providing distribution delivery service.

With the development of competitive gas commodity markets since 1985, most industrial and some larger commercial customers now buy the natural gas commodity directly from a producer or other supplier and use only distribution services from SaskEnergy. Utility sales, where SaskEnergy sells the gas commodity, now represent only about one-half of total SaskEnergy deliveries. SaskEnergy purchases natural gas for its sales customers, and contracts for the transport of the gas to TEP, the notional receipt point for its delivery rates. The cost of buying the gas commodity and transporting it to TEP is recovered in the Gas Consumption Charge. In 1998, SaskEnergy redesigned its rates and bills to show the delivery rates and the Gas Consumption Charge separately.

1.3 Approval of Rates

SaskEnergy and TransGas establish rates, charges, and terms and conditions of service for the services that each company provides to its customers. Each company must describe all rates and conditions of service in a schedule that is available to the public. The rates are subject to approval by the Saskatchewan Cabinet.

A Minister's Order dated July 27, 2000, pursuant to The Government Organization Act, established the Saskatchewan Rate Review Panel (the "Panel") as a Ministerial Advisory Committee to review and provide an opinion on the fairness and reasonableness of proposed Crown Corporation rate changes, and to

consider the interests of the customer, the Crown Corporation and the public in its opinions. A subsequent Minister's Order, dated May 1, 2001, requested that the Panel review SaskEnergy's request for the change to its Gas Consumption Charge for the period June 2001 through October 2002, and set out Terms of Reference for the review. The Terms of Reference stated that several matters, including the current operating rate structure, corporate policies, approved capital allocation, annual rate of return target, rate base, existing service level, and the methodology to allocate cost of service among rate classes, are to be considered as given. The Panel is to present its report to the Minister of Crown Investments Corporation of Saskatchewan by June 1, 2001. The two Minister's Orders are Attachment 1 to this Report.

1.4 Purpose of BCUC Staff Review Report

The staff of the British Columbia Utilities Commission ("BCUC") were engaged by the Panel to undertake a review of the increase in Gas Consumption Charge that SaskEnergy requested. BCUC staff are to provide a recommendation to the Panel as to the fairness and reasonableness of the proposed rate increase, consistent with the Terms of Reference for the Panel's review of SaskEnergy's Applications. BCUC staff act as independent advisors to the Panel to assist it in providing its recommendations to government with respect to the rate increases. The results of the BCUC staff review are set out in this Report. Attachment 2 of the Report outlines the services to be provided by BCUC staff. Attachment 3 describes the normal role of BCUC staff, outlines the delivery charge and gas cost approval process in British Columbia and provides biographies for staff members Brian Williston and Bill Grant who prepared the Report.

2.0 LOAD FORECAST

2.1 Annual Load Forecast

SaskEnergy forecasted the following sales and purchase volumes, in TJ (Application, Chapter 4). The load adjustment of 1,169 TJ in June 2001 results from an annual reconciliation to balance accumulated monthly load estimates to actual annual receipts from TransGas. SaskEnergy sells a small amount of gas to its subsidiary Swan Valley Gas Corporation for customers in Manitoba. That gas is priced at SaskEnergy's Gas Consumption Charge plus an allocation of storage costs.

SaskEnergy Sales and Purchases (TJ)

	June - October 2001	November 2001 to October 2002	June 2001 to October 2002
SaskEnergy Sales	10,783	65,003	75,786
Swan Valley	9	140	149
Load Adjustment	(1,169)	0	(1,169)
Total Sales	9,623	65,143	74,766
SaskEnergy Usage	104	450	554
TransGas Fuel and Loss	140	154	294
Gas to Storage	15,873	0	15,873
Total Purchases	25,740	65,747	91,487

The corresponding SaskEnergy sales volume forecast for 2000/01 was 64,600 GJ.

To derive its annual load forecast, SaskEnergy multiplied the expected annual use per customer for each customer class under normal weather conditions times the expected average number of customers in each rate class. The assumed use per customer is based generally on weather adjusted data for the past three to five years. SaskEnergy noted that a trend of declining use per residential customer continues to be evident. Based on the average normalized residential use per customer over the past three years, SaskEnergy forecasted 128.3 GJ for 2001/02, a 1.6 percent decline from the previous year.

2.2 Design Peak Day Forecast

SaskEnergy's peak day forecasting methodology was revised for 2000/01, and the forecast results were consistent with actual loads during cold weather in December 2000. The forecast peak day load was derived as the product of the forecast use per customer on the peak day and the estimated number of customers on that day. The forecast use per customer on the peak day was based on a regression analysis of the relationship between peak day use per customer and weather (temperature and wind). The regression used historical data from the past 10 years to estimate the use per customer for weather conditions with a 1 in 20 probability of occurring in the test year. This is consistent with the design criteria used by gas utilities elsewhere.

SaskEnergy forecasted a design peak day load of 603.0 TJ for 2001/02, which is the same as the forecast for 2000/01. Customers who buy gas directly from suppliers will provide 5.0 TJ/d of peak supply.

2.3 BCUC Staff Assessment

As the Gas Consumption Charge is intended to flow-through SaskEnergy's cost of purchasing gas, the accuracy of the annual load forecast is not as critical as it would be if the Utility's Delivery Charges were under review. Based on a limited review and comparison to SaskEnergy's forecast for 2000/01, BCUC staff consider that the 2001/02 annual forecast should be accepted as reasonable.

It appears that SaskEnergy thoroughly analyzes and monitors its peak day requirements. Consequently, the design peak day forecast appears reasonable, and should also be accepted.

3.0 SUPPLY PORTFOLIO

Saskatchewan and SaskEnergy are in a favourable position to arrange a secure, flexible and relatively low cost supply of natural gas for consumers. Production within Saskatchewan exceeds consumption and several large transmission pipelines cross the province carrying mainly Alberta production to market. The Alberta Energy Company ("AECO") gas trading point in Alberta is very liquid, and provides a reliable market reference price along with opportunities for financial price risk management activities. Moreover, AECO prices are expressed in Canadian dollars.

Perhaps most importantly, SaskEnergy has access to underground gas storage in old gas fields and caverns that are conveniently located close to its major markets. The Utility relies on storage gas to meet about two-thirds of its design peak day demand. Saskatchewan consumers benefit greatly from the available storage in proximity to load requirements.

3.1 Contracted Gas Supply

SaskEnergy's annual load and peak day demand forecasts were discussed in Chapter 2. SaskEnergy designed its gas supply portfolio to give the least cost, while providing the required flexibility and security of supply. The Utility relies mainly on storage gas and gas purchase contracts to supply daily sales demand, and anticipates buying a small amount of winter term or spot gas to handle very cold weather. With ready access to liquid gas markets, such gas should be available for purchase when needed, although the price may be high.

In addition to meeting annual and peak day demands, the Utility carefully monitors weather and storage levels during the November through March winter period, when most gas is sold (Application, Chapter 5). To the extent the weather is colder than average and sales are higher, SaskEnergy will buy additional winter spot supply. This was the case in November and December 2000. Although SaskEnergy bought 1.0 PJ of additional spot gas in December 2000, the storage inventory at the end of December was only

57 percent of the inventory at the start of November. In its normal year forecast for 2001/02, SaskEnergy projects that 67 percent of the storage inventory will remain at the end of December.

On the other hand, if sales are lower, the Utility may sell the surplus in the marketplace or keep it in storage inventory. This occurred in early 2001, when SaskEnergy sold 0.75 PJ in April 2001.

SaskEnergy buys most of its gas supply under year-round contracts that are medium term (term of 1 to 5 years) and long term (term greater than 5 years). A small amount of daily or monthly spot purchases provide flexibility to provide for load variations due to weather. SaskEnergy made changes to improve the presentation of information about the supply contracts. Reviews of previous Commodity Rate Applications have confirmed that detailed contract information support the schedules in the Application, and so this time BCUC staff have not reviewed details about individual supply contracts. The portion of total purchases that the Utility expects to acquire in Saskatchewan has increased to virtually 100 percent for 2001/02, as current market price differentials favour this shift.

SaskEnergy's gas purchase contracts generally have annual price reopeners. A small number of contracts have fixed pricing, while prices for the large majority of purchases are referenced to the AECO monthly index. Natural gas price differentials for deliveries at the Saskatchewan field points and at the TEP interchange point relative to the AECO index, are established by the marketplace through negotiation and reflect supply and demand considerations as well as transportation costs. SaskEnergy is very active in the marketplace and follows these price differentials closely.

3.2 Price Risk Management

In previous years, SaskEnergy established its Gas Consumption Charge as a gas sales rate that was fixed for one year. Unlike several other gas utilities in Canada, until November 1999 it did not have a gas cost variance account in which to record differences between forecast and actual gas costs. To reduce the price risk from its AECO index-based purchases, the Utility used financial instruments to convert most of its index-based purchases to fixed pricing. SaskEnergy also purchased call options, which limited its upward cost exposure, but enabled it to benefit when market prices were lower. SaskEnergy's strategy was to implement its price risk management strategy in advance of the start of the gas year. The Utility established a fixed price for its gas purchases that reflected the average of the market price expectations, and which was the basis for the fixed gas commodity rate for the year. This approach allowed SaskEnergy to shield customers from volatile gas prices, and also generally delayed the impact on rates of rising gas prices over recent years.

Natural gas prices were trading at record high levels in Western Canada and across North America as the 2000/01 gas contract year approached. SaskEnergy expected that weather could cause prices to increase or

decrease significantly. SaskEnergy fixed the price of a portion of the gas in its portfolio for 2000/01, and entered into some option arrangements. These activities plus the gas that was in storage secured about half of the supply for 2000/01 at prices that are well below market prices. The hedging has materially benefited customers to date, and is projected to have a total benefit of almost $80 million over the 2000/01 gas year.

Nevertheless, due to the very high price levels and extreme price volatility, SaskEnergy also maintained a significant portion of its portfolio with indexed prices. Cold weather in November and December 2000, combined with concern about the adequacy of storage levels, lead to prices in the $12.00/GJ range, 300 percent above prices a year previous. The high prices for the unhedged portion of purchases caused a large debit balance to accumulate in the gas cost variance account.

Forecast gas prices for the period through October 2002 were in the $7.00/GJ range when SaskEnergy prepared the Application. More recently prices have dropped to about $6.00/GJ, as a result of strong early storage refill rates across North America which are attributed to reduced gas demand from industrial users like fertilizer producers and petrochemicals and improved supply due to increased drilling.

For the next gas year of 2001/02, SaskEnergy continues to be concerned that many of the recent supply pressures remain. Many new gas-fired generation plants are scheduled to start up this summer. Gas storage levels in the United States are lower than they were a year ago, and demand for gas-fired electrical generation in the summer is expected to compete with the need to refill storage. A strong increase in the number of wells drilled is only starting to yield a material increase in gas production. Current softer prices may encourage some industrial plants to resume operation, and present indications are that the general slowdown in growth in the U.S. economy is likely to be relatively limited.

On this basis, SaskEnergy used the following two principles to develop its price management strategy for 2001/02:

1. Protect consumers from any significant increase above current market prices and from temporary price spikes; and

2. Allow customers to participate in potential market price declines.

The Utility has extensively hedged its 2001/02 purchases by buying call options to set a cap price. The options permit SaskEnergy and its customers to benefit from market prices that are below the cap. Some of the call options are associated with the sale of a put option that sets a floor price, thus forming a "costless" collar for a portion of the hedges. SaskEnergy intends to sell additional put options for 2001/02 and the premiums received will be credited to the cost of gas.

3.3 BCUC Staff Assessment

The Terms of Reference direct the Panel to consider the reasonableness of the proposed rate change in the context of SaskEnergy's gas purchase contracts and other cost factors related to the supply of natural gas. BCUC staff consider the review will focus on the likely cost impacts of SaskEnergy's gas contracting and price management actions, and that the Company's gas contracting strategy and price management objectives and strategy are generally outside the scope of the review. Nevertheless, considering the impact these actions can have on gas costs and rates, BCUC staff are of the view that some oversight is appropriate. Preferably, this would include regulatory review of the Utility's gas contracting strategy and price risk management strategy prior to implementation. A price management plan could also address matters such as credit-worthiness limits for counter-parties, and the front office/back office accounting structures that are in place to confirm the recording of transactions.

SaskEnergy has developed a supply portfolio for 2000/01 that seems appropriate to meet the needs of its customers at the lowest overall cost, considering its location and the opportunities available. Although the analysis that established the detailed makeup of the portfolio has not been reviewed, it is felt that such further review is not warranted. The arrangements that are in place for 2000/01 appear reasonable and the Utility is in the best position to optimize its portfolio. A regulator should not want to intrude on a utility's management function beyond what is necessary to assure the public that efficient operations exist.

The negotiated prices for the great majority of gas purchase contracts rely on the AECO index, which is a reliable indicator of market prices. The basis differentials relative to this index seem reasonable.

SaskEnergy has successfully hedged the price of gas purchases for several years. The strategy for 2001/02 is a considerable evolvement from past practices of hedging at a fixed price, and was developed in response to the current high level and volatility of market prices. It requires a significant outlay for the premiums to buy the options, but appears to reasonably meet the objectives of the strategy.

4.0 GAS COST VARIANCE ACCOUNT

The actual cost of gas can vary from forecast for a number of reasons, of which two are particularly significant. First, gas that does not have a fixed price will be bought at actual market prices at the time of purchase. Second, load variations caused by weather will affect the proportions of purchased and storage gas supply that is sold. Most gas utilities in Canada have a deferral account in which to record differences between actual and forecast gas costs. SaskEnergy's Board of Directors approved a Gas Cost Variance Account ("GCVA") to be effective November 1, 1999.

SaskEnergy's GCVA as currently structured does not record the difference between the actual and forecast cost of gas, but instead records the actual commodity cost of gas compared to actual commodity revenue from sales of gas. The GCVA is compensating not only for differences between the actual cost of gas and the forecast cost that is embedded in the rates, but also for differences in the volume of sales. BCUC staff consider that this form of deferral account is justified in order that SaskEnergy fully recovers its prudently incurred actual costs of providing the gas commodity to customers, without a mark-up.

The actual commodity cost of gas recorded in the GCVA includes all cost items in the Commodity Rate Application. Commodity revenue will include actual commodity revenue from the Gas Consumption Charge, revenue from excess gas sales and late payment charges. Interest expense for gas in storage is being recorded in the account. This is consistent with the current Delivery Charges, from which storage gas interest costs were excluded.

4.1 GCVA Balances

The GCVA had a credit balance of $1.4 million at October 31, 2000, $0.3 million lower than forecast due to the effect of the higher heating value of the gas on sales volume (Application, Chapter 2). SaskEnergy projects the balance will be a debit of $80.2 million at May 31, 2001. The Application includes a detailed analysis of the factors that contributed to the $81.6 million that accumulated over the seven month period, as follows:

GCVA Balance November 2001 – May 2001, Millions of Dollars

Higher gas price	$ 73.8
Higher cost gas injected into storage	(7.6)
Rate increase delay to December 1, 2000	12.3
Heating value variance	1.3
Storage/purchase volume ratio	3.3
Transportation costs	0.2
Other gas sales profit	(3.1)
Interest November 2000 to May 2001	1.3

The Application projects the following GCVA balances and recoveries, assuming approval of the Gas Consumption Charge proposed by SaskEnergy. In response to an Information Request, SaskEnergy also provided the following forecast that was based on May 10, 2001 forward prices. A May 31, 2001 balance of $80.2 million is used for both cases in this Report.

Projected GCVA Balance, Millions of Dollars

	Application	May 10, 2001 Prices
Balance May 31, 2001	80.226	80.2
Recoveries, June 2001 to October 2001	(17.355)	(20.7)
Interest charge, June 2001 to October 2001	1.322	1.3
Balance October 31, 2001	64.193	60.8
Recoveries, November 2001 to October 2002	(35.541)	(49.4)
Interest, November 2001 to October 2002	1.720	1.1
Balance October 31, 2002	30.372	12.5

The proposed total recovery in gas charges related to the GCVA of $52.896 million consists of $49.854 million of the May 31, 2001 GCVA balance and $3.042 million of GCVA interest charges.

4.2 BCUC Staff Assessment

SaskEnergy appears to be administering the GCVA generally as anticipated. BCUC staff have limited review of the GCVA to the information that was in the Application. At some point it may be worthwhile for the Panel to commission a more detailed audit of costs and revenues that have been recorded in the account.

Debit account balances attract interest at SaskEnergy's short-term borrowing rate, which is forecast to be five percent. SaskEnergy proposes that credit balances (those in favour of the customer) will receive interest at the rate earned as short-term investments. Although the difference between these two rates is likely to be small, BCUC staff favour the use of the short-term borrowing rate in all circumstances, in the interest of symmetry and ease of calculation.

Late payment charge revenue is expected to be $0.1 million lower than the forecast in the application for 2000/01 rates. This is an example of operating expenses and revenue that are related to the gas supply activity. While it is reasonable to include these costs and revenue in the Gas Consumption Charge, they are considered to be controllable. BCUC staff consider it inappropriate for SaskEnergy to recover variances from the forecast that was used in the setting of rates. However, due to the small size of the variance, no adjustment is felt to be warranted.

The large balance currently in the GCVA is of concern, but appears to be manageable. The massive gas price increase last winter had a similar impact on many utility gas cost variance accounts. SaskEnergy had intended to consider applying for a rate change if the account balance reached $20 million, and in any case

by the end of March each year. However, the speed of the price increase and other factors probably made the accumulation of a sizeable balance inevitable. Nevertheless, so long as gas prices remain very volatile, BCUC staff recommend that SaskEnergy and the Panel consider the establishment of formal reviews of the account balance on a frequent, perhaps quarterly, basis.

Another consideration is the time period over which the account balance should be amortized. Arguments in favour of amortization over one year are that this reduces interest charges, inter-generational inequities, and the period during which utility rates are not aligned with market prices. On the other hand, amortization over one year can exacerbate the impact of gas price increase on customers, and can make the utility's rates less competitive with marketers. Considering the size of the proposed total rate increase, the latter concerns are factors in the present situation.

The following table illustrates several possible amortizations of the GCVA balance, including interest:

GCVA Balance Contribution to Gas Consumption Charge, $/GJ

		June 2001 to May 2002 (12 months)	June 2001 to October 2002 (17 months)	June 2001 to May 2003 (24 months)	June 2001 to May 2004 (36 months)
Gas Sales,	PJ	65.1	74.8	130.2	195.3
Application,	$52.896 million		$ 0.71		
GCVA Balance,	$83.268 million	$ 1.28	$ 1.11	$ 0.64	$ 0.43

It is apparent that SaskEnergy's proposed rate, which anticipates a GCVA balance of $30.4 million at October 31, 2002, is approximately equivalent to a two year amortization of the entire account balance. A quicker amortization would increase the already large rate impact, while there are limited benefits of using a longer period. BCUC staff consider that the amortization proposed by SaskEnergy is reasonable.

Also, due to the size of the GCVA balance, a question arises whether current sales customers who benefited from lower rates last winter and contributed to the debit balance, should be able to evade responsibility for the balance by moving to another supplier of the gas commodity. As discussed with respect to 2000/01 rates, a GCVA rate rider can be used to separately identify and account for the effect of the GCVA balance on customer rates. The proposed rate for June 2001 of $0.2826 per cubic metre ($7.62/GJ) could be expressed as a GCVA Charge of $0.0262 per cubic metre ($0.71/GJ) and a Gas Consumption Charge of $0.2563 per cubic metre ($6.91/GJ), assuming that SaskEnergy's billing system can handle the additional information. The GCVA Charge could apply to all customers who contributed to

the current account balance, for an appropriate period of time. BCUC staff recommend this approach for the recovery of the current GCVA balance, provided it is administratively possible for SaskEnergy to do.

5.0 FORECAST COST OF GAS

The sales load forecast under average weather conditions and the portfolio of gas purchase contracts that were reviewed in earlier Chapters, were used to estimate the corresponding forecast 2001/02 Cost of Gas Sold of $460,630,000 (Application, Chapter 1). The Application assumed an AECO Index price of $6.75/GJ for the year. Appendix 1 compares the forecast for 2001/02 to the forecast for 2000/01 that was the basis for current rates and to actual/projected numbers for 2000/01.

SaskEnergy has requested that detailed proprietary information about its supply arrangements be kept confidential, as disclosure would disadvantage the Utility and its customers. This request for confidentiality of commercially sensitive information is consistent with disclosure requirements in other provinces where commodity competition exists.

5.1 Cost of Gas Purchases

In the Application for June 2001 rates, SaskEnergy revised the format of the schedules that support the forecast Cost of Gas Purchases. The new format is more consistent with SaskEnergy's current portfolio of supply contracts and price hedges, and clarifies the off-system transportation charges that are recovered in the Gas Consumption Charge.

Fixed Price Contracts and Fixed Hedges

SaskEnergy buys a small amount of gas under fixed price contracts. SaskEnergy can also use financial instruments to convert a portion of AECO pricing to fixed prices. The prices for these purchases are known for the forecast period.

Options

For a substantial portion of the gas purchases with AECO pricing, for 2001/02 SaskEnergy purchased call options to limit the cost exposure if prices increase further, while providing some opportunity for cost savings if market prices decline. SaskEnergy also sold put options, which establish a gas price floor. This is an alternative to financially fixing prices. When forecast prices are above the "strike" or reference price for a call option, or below the strike price for a put option, the option acts to fix the cost of gas to SaskEnergy at the strike price. Based on its price forecast, SaskEnergy estimates the hedging benefit or cost that such options provides.

The option premiums that SaskEnergy paid to buy call options or received when it sold put options are also included in the Cost of Purchase Gas. Interest charges related to option premium costs are included under Operating Expenses and Interest.

Contracts with AECO Pricing and Price Differentials to AECO

Almost all of SaskEnergy's gas purchases have pricing that is referenced to AECO, plus a negotiated basis differential to adjust the price to the actual point of receipt of the gas. SaskEnergy calculates an average basis differential for each receipt point. The forecast of basis differentials in the Application was prepared prior to finalizing prices under many contracts. Any differences between forecast and actual differentials should be small and will be recorded in the GCVA, and BCUC staff consider that the forecast of basis differentials in the Application is reasonable.

The new Application format used the average forecast basis differentials and a forecast of gas prices to calculate the forecast price and gas cost at each receipt point. There is risk in any price forecast, particularly in this period of extremely volatile market prices.

Gas prices declined somewhat after SaskEnergy prepared the forecast in the Application. In Response to an Information Request, SaskEnergy recalculated the Cost of Gas Sold using forward market prices as of May 10, 2001 of $6.05/GJ at AECO. With this price forecast, the Cost of Purchase Gas in June through October 2001 would decrease by $7.1 million to $154.4 million. These forward prices would also reduce the forecast Cost of Purchase Gas for 2001/02 by $13.7 million to $457.7 million. Appendix 1 shows that the Cost of Gas for June 2001 through October 2002 would be $17.606 million lower, while Operating Expenses and Interest would be down by $0.0940 million, for a total reduction of $17.700 million.

5.2 Transportation Costs

SaskEnergy contracts TransGas transportation service for moving gas to the TEP interchange point from Saskatchewan field receipt points or interconnects at the Saskatchewan/Alberta border. The Utility has reduced the amount of TransGas service for 2001/02, as it plans to buy more gas at TEP. The amount contracted for 2001/02 corresponds to expected Saskatchewan field purchases and spot gas purchases. SaskEnergy pays for the service at TransGas' current published tariff rates, which have been approved by the Saskatchewan Cabinet and will be frozen until December 31, 2001. An assessment of the level of current TransGas rates is outside the scope of this Report.

SaskEnergy also contracts for TransCanada Alberta (previously Nova Gas Transmission Division) transportation service to the Saskatchewan border, and pays rates approved by the Alberta Energy and Utilities Board for the capacity. For 2001/02, SaskEnergy will not purchase long or medium term gas in Alberta and the TransCanada Alberta service contract will be permitted to expire at the end of 2001.

SaskEnergy appears to be carefully managing the amount of transportation that it contracts for. Expiry of the TransCanada Alberta service will reduce costs by $2.0 million, and the reduction in TransGas service will reduce costs a further $1.9 million. The rest of the apparent reduction in transportation costs shown on Appendix 1 reflects how such costs are reported in the new Cost of Gas Sold format.

5.3 Change in Storage Inventory Value

Gas injected into storage is valued at the average cost of acquiring the gas that month at the TEP interchange point. This cost includes the gas purchase cost including hedging effects and the cost of transportation to TEP. Gas withdrawn from storage is priced at the average cost of gas in inventory.

In April 2001 at the conclusion of the 2000/01 heating season, SaskEnergy sold 0.75 PJ of excess supply into the marketplace, and credited the revenue to customers via the GCVA. SaskEnergy deemed that the gas sold had a cost equal to the average cost of gas in storage at the end of winter, rather than the cost of gas purchased in April, as it considered that it was selling surplus storage inventory from the winter. As discussed in the BCUC Staff Report dated November 20, 2000 regarding 2000/01 rates, BCUC staff are concerned that the deemed cost was not consistent with the average cost of gas methodology that the Utility uses for storage inventory. Also, the cost of gas purchased in April seems to be a better basis for making decisions about surplus gas sales. Nevertheless, the use of a deemed price for the surplus sales will not have a material effect on rates for 2001/02, and therefore no adjustment is required.

The expected higher price of gas to be stored in the summer of 2002 means that the value of gas in storage is anticipated to increase significantly over the gas year. This results in a reduction in the gas costs to be recovered from customers in 2001/02. This cost reduction has been appropriately recognized by SaskEnergy in its Application.

5.4 Internal SaskEnergy Usage

SaskEnergy uses some gas for the operation of its distribution system. It buys this gas as part of its supply procurement, and recovers the cost of the gas through its delivery rates. The cost of Internal Usage gas is deducted from the cost of gas, with the credit calculated at the average cost of gas, including transportation to the TEP interchange point.

For 2001/02, SaskEnergy forecasts 450,000 GJ of gas valued at $3,182,000 as Internal Usage. BCUC staff consider that the forecast is reasonable.

5.5 Operating Expenses and Interest

In order to maintain an equitable balance of costs between Utility sales and delivery service for directly purchased gas, SaskEnergy includes costs that are related to gas procurement and management in the commodity cost of gas. For 2001/02, these costs are forecast as follows:

	2000/2001 2000 Application	2000/2001 Projected	2001/2002 Application
OM&A and Overhead	$ 1,063,000	$ 1,063,000	$ 1,063,000
Depreciation and Corporate Capital Tax	250,000	250,000	250,000
Net Bad Debt/Late Payment Fees	(356,000)	(161,000)	(248,000)
Interest on Gas in Storage and Option Premiums	2,738,300	2,609,000	5,820,000
Other Interest	40,000	40,000	40,000
	$ 3,735,300	$ 3,801,000	$ 6,925,000

Interest costs are calculated using SaskEnergy's short-term borrowing rate. The higher cost of gas in storage contributes to the increase, but the main cause is interest related to option premiums. Also, the net revenue from bad debt expenses and late payment fees is forecast to be somewhat lower.

BCUC staff support including these costs in the Gas Consumption Charge for Utility sales customers, to ensure that the Utility competes fairly with other gas marketers. The cost forecast for 2001/02 is considered to be reasonable, even though the cost of options is considered to be quite high.

5.6 BCUC Staff Assessment

As discussed in the preceding sections, BCUC staff generally accept the gas costs in the Application as reasonable. There are, however, two areas where modest adjustments appear to be needed.

Gas Price Forecast

The price forecast in the Application, and the hedging that is in place, means that the forecast cost of gas is what SaskEnergy described as a "worst case" scenario. At the same time, unforeseen events could cause relatively modest cost increases. For example, very cold weather could cause SaskEnergy to buy expensive spot gas and these additional costs would be recorded in the GCVA. Nevertheless, the

proposed rate is likely to reduce the GCVA balance at October 31, 2002 to about $30.4 million under any high price scenario. The GCVA balance will be less if gas prices are below the forecast.

While the price volatility over the past year has been unsettling, BCUC staff consider that gas rates should be set based on most likely rather than worst case price forecasts. As discussed in Section 5.1, using more current May 10, 2001 forward prices would reduce forecast gas costs by $17.7 million. To continue to target a GCVA balance of $30.4 million at October 31, 2002, the corresponding GCVA interest charges of $3.042 million for June 2001 to October 2002 should continue to be used.

Premium from Sale of Put Options

SaskEnergy sold some put options for 2001/02, and anticipates that it will sell more in the future. The amount to be sold is uncertain, as is the premium that will be obtained from their sale. In response to an Information Request, SaskEnergy stated that $12 to 17 million is a reasonable estimate of revenue from future sales of put options.

Consistent with the Utility's price management strategy, it seems likely that SaskEnergy would only refrain from selling the options if it feels that gas prices were likely to continue to soften. Taking the view that rates should be based on the most likely forecast of gas costs, BCUC staff consider that a forecast of an additional $12 million of put option premiums is reasonable.

The total adjustment would then reduce gas costs for the June 2001 to October 2002 period by $29.7 million. It may be noted that a worst case price scenario would cause the GCVA to have a debit balance of about $60 million. Recognizing that very cold weather or other factors could cause some additional gas costs, it appears unlikely that the GCVA balance at October 2002 will exceed the $80.2 million that is projected for May 31, 2001.

BCUC staff recommend that the two foregoing adjustments be made to the forecast Cost of Gas Sold.

6.0 GAS CONSUMPTION CHARGE

Gas prices for 2001/02 are extremely volatile and difficult to predict with any confidence. The forecast increase in commodity costs is largely beyond the control of SaskEnergy. The Utility has done an efficient job of mitigating the exposure of customers to higher prices during this period of high North American demand and constrained production capability.

SaskEnergy's hedges have largely eliminated exposure to upward price movements. Customers will benefit if prices are lower. BCUC staff recommend that the Gas Consumption Charge be based on the

current likely forecast of gas prices and that $12 million of revenue from future sales of put options be included. BCUC staff also recommend that SaskEnergy's target of a $30.4 million GCVA balance remaining at October 31, 2002 be accepted for the calculation of rates.

SaskEnergy used a sales volume of 2,046,821 thousands of cubic metres to calculate the Gas Consumption Charge. The information supporting the Cost of Gas Sold forecast indicates 2,015,316 thousands of cubic metres, which is 74.8 PJ. The difference appears to be the load adjustment referred to in Section 2.1. BCUC staff recommend that the number that is consistent with the gas cost forecast be used in the calculation. The matter also raises the question whether, with the convergence that is occurring in energy, SaskEnergy should shift its rates and billing to an energy basis.

As discussed in Chapter 4, the rate could also be presented as a GCVA Charge and a lower Gas Consumption Charge. Appendix 1 estimates the resulting Gas Consumption Charge to be $0.2439 per cubic metre ($6.57/GJ) and the GCVA Charge to be $0.0262 per cubic metre ($0.71/GJ). The total gas charge is $0.2701 per cubic metre ($7.28/GJ), and the increase from the current Gas Consumption Charge is $0.1032 per cubic metre ($2.78/GJ) or 62 percent. The corresponding change in the annual bill of a typical residential customer is an increase of $356, or 38 percent.

If gas prices go up, the GCVA balance will still be drawn down over the period, but at a slower rate. It appears unlikely that a further rate increase will be required over the 17 month period. If gas prices fall, the GCVA balance will be drawn down more quickly. Although current forecasts do not indicate that the account balance is likely to become positive before October 2002, it would be reasonable for SaskEnergy to consider filing for a rate reduction if the debit balance accumulated in the GCVA reduces to a level below $20 million.

In response to an Information Request, SaskEnergy provided information that electricity is the most competitive alternative fuel, with a cost of $0.0736 per kilowatt hour. Compared to a gas furnace that is 60 percent efficient, and assuming the recommended gas charge of $0.2701 per cubic metre, using electricity would increase heating costs by 32 percent. Natural gas, therefore, remains the preferred heating fuel in Saskatchewan.

6.1 BCUC Staff Recommendations on Gas Consumption Charge

BCUC staff are of the opinion that the forecast set out in SaskEnergy's Commodity Rate Application and the rate derived from it are generally fair and reasonable, subject to the following recommended changes.

Recommendation:

- Direct SaskEnergy to forecast the Cost of Gas Sold for the period June 2001 through October 2002 to reflect current forward market prices such as those of May 10, 2001;
- Direct SaskEnergy to include $12 million of revenue from additional put option sales in the Cost of Gas Sold for the period;
- Direct SaskEnergy to target a forecast GCVA balance of $30,372,000 at October 31, 2002 and to use a Volume Available for Recovery of 2,015,316 thousands of cubic metres, in its calculation of Gas Consumption Charge;
- Direct SaskEnergy to recalculate the Gas Consumption Charge effective June 1, 2001, and to separately identify the component that relates to recovery of the GCVA balance and GCVA interest costs. The resulting Gas Consumption Charge and GCVA Charge are expected be about $0.2439 per cubic metre ($6.57/GJ) and $0.0262 per cubic metre ($0.71/GJ), respectively; and
- Direct SaskEnergy to charge the GCVA rider to all current Utility sales customers, including those who buy the gas commodity from other suppliers in the 2001/02 gas contract year.

This Report is submitted as of May 28, 2001.

J.B. Williston, Manager
Engineering and Commodity Markets

W.J. Grant, Executive Director

SaskEnergy Incorporated

Cost of Gas Sold
(in $ 000's)

	2000/01 Approved	2000/01 Projected	2001/02 Application	June 2001 to October 2002 Application	June 2001 to October 2002 Adjusted[1]
Cost of Purchase Gas	303,915	436,447	471,415	632,906	612,136
Transportation Costs	13,480	6,693	2,745	5,497	5,497
Net Change in Storage Inventory	(26,939)	(69,209)	(17,272)	(120,285)	(117,221)
Subtotal	290,456	373,931	456,887	518,118	500,412
Cost of Other Gas Sales	0	2,369	0	0	0
Deduct Cost of SaskEnergy Internal Use	(2,116)	(3,108)	(3,182)	(3,789)	(3,689)
Cost of Gas	288,340	373,192	453,705	514,329	496,723
Operating Expenses and Interest	3,735	3,800	6,925	8,637	8,543
Intra Period Variance	0	0	0	(1,834)	(1,834)
GCVA Balance Recovery	(156)	(1,361)	0	0	0
Adjustment for Put Option Revenue	0	0	0	0	(12,000)
Adjusted Cost of Gas Sold	291,920	375,631	460,630	521,130	491,432
Quantity Sold, PJ	64.6	64.6	65.1	74.8	74.8
Cost of Gas Sales, $/GJ	4.52	5.81	7.08	6.97	6.57
GCVA Balance Reduction				80,226[3]	49,854[5]
GCVA Interest				3,042[4]	3,042
GCVA Recovery				83,268	52,896
Volume Available for Recovery, $10^6 m^3$	1748.9		1,755.9	2,046.82	2,015.32[6]
Gas Consumption Charge (Full GCVA Recovery), $/m³	$0.1669			$0.2953	
Gas Consumption Charge (Recommended[2]) $/m³				$0.2826	$0.2439
GCVA Charge, $/m³				0	$0.0262
Total of Gas Charges, $/m³				$0.2826	$0.2701

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1 Adjusted gas costs are based on May 10, 2001 forward AECO gas prices.
2 Recommended Gas Consumption Charges are based on a GCVA debit balance of $30,372,000 at October 31, 2002.
3 Full recovery of May 2001 GCVA balance; SaskEnergy recommends an October 2002 remaining balance of $30,372,000.
4 GCVA Interest June 2001 to October 2002, with a $30,372,000 October 2002 balance, is $1,322,000 + $1,720,000.
5 Adjusted GCVA balance recovery is calculated as $80,226,000 - $30,372,000.
6 Adjusted Volume for Recovery is total sales for June 2001 to October 2002 from Schedules 2.8.1 and 4.1.

RECEIVED
JUL 31 2000
Clerk of the Executive Council

MINISTER'S ORDER

The Establishment of the Ministerial Advisory Committee Saskatchewan Rate Review Panel

I, John T. Nilson, Q.C., Minister of Crown Investments Corporation pursuant to section 16 of *The Government Organization Act* do hereby order that:

1. There shall be established a ministerial advisory committee known as the Saskatchewan Rate Review Panel (herein referred to as the Panel);

2. The Panel, as its mandate:

   (a) shall conduct a review and provide an opinion of the fairness and reasonableness of proposed Crown Corporation rate changes, referred to the Panel by the Minister of Crown Investments Corporation, considering the interests of the customer, the Crown Corporation, and the public; and

   (b) shall incorporate as part of its mandate specific terms of reference for particular Crown Corporation rate change reviews that may be attached by further minister's order.

3. Crown Corporation means SaskEnergy, SaskPower, and SGI AutoFund

4. The following persons are appointed as members of the Panel for a term not to exceed July 25, 2002:

Bob Lacoursiere	Saskatoon
Tracey Baldoni	Regina
John Boan	Regina
Jo-Ann Carignan-Vallee	Assiniboia
Sheldon Craig	La Ronge
Joan Meyer	Swift Current

5. Bob Lacoursiere is designated as chairperson of the Panel;

6. In conducting its review, the Panel shall:

   (a) receive a rate change submission from a Crown Corporation;

   (b) establish procedures for conducting the review and ensure that these procedures are made available to the public;

   (c) engage the services of a consultant(s) to assist the Panel in its review of the fairness and reasonableness of the proposed rate change;

(d) make available to the public, prior to holding public meetings, the Crown Corporation rate change submission, with the exception of commercially sensitive information;

(e) hold public meetings and provide appropriate notification to the public of the date and location of public meetings, including any rules for public participation and Crown Corporation participation;

(f) provide members of the public with the opportunity to review and comment on the proposed rate changes to the extent reasonably allowed by the mandate of the Panel and by the schedule according to which the Panel is required to complete its work and provide its report to the Minister of Crown Investments Corporation;

(g) receive presentations of the consultant(s) or the Crown Corporation, review any written submissions and receive comments from the public;

(h) prepare a report on the Crown Corporation rate change submission for the Minister of Crown Investments Corporation after considering material received from the Crown Corporation, the consultant(s), the public, and its own analysis:

(i) where the Panel determines the rate changes as proposed are fair and reasonable, recommend that the changes be implemented; or,

(ii) where the Panel determines the rate changes are not fair and reasonable as proposed, recommend that the rate changes be adjusted providing reasons for this conclusion;

(i) provide its report respecting the proposed rate changes to the Minister of Crown Investments Corporation on a date set out in or within any time period after having received the rate change submission that is contained in specific terms of reference for particular Crown Corporation rate reviews; and

(j) make its report available to the public;

7. The Panel may utilize the services of such independent experts, clerks, reporters and assistants that are engaged on its behalf, as it deems necessary or advisable to aid and assist the Panel in its review;

8. Remuneration shall be paid to the panel members as follows:

(a) a retainer of $9,000 per annum and a per diem of $700 per day for the chairperson while engaged in the work of the Panel; and

(b) a retainer of $6,000 per annum and a per diem of $500 per day for the other members while engaged in the work of the Panel;

9. Panel members shall be reimbursed for traveling and expenses according to the approved Crown Investments Corporation policy outlined in the Remuneration Schedule and Expense Guidelines for Directors appointed to Crown Investments Corporation Subsidiary Crown Boards; and

10. Payment of remuneration, reimbursement and expenses incurred in the conduct and administration of the review shall be paid by Crown Investments Corporation.

Dated at the City of Regina, Saskatchewan, this 27th day of July, 2000.

Minister of Crown Investments Corporation

Saskatchewan Rate Review Panel
SaskEnergy Gas Consumption Rate Change

WHEREAS by a Minister's Order dated July 27, 2000, issued pursuant to section 16 of *The Government Organization Act*, the Minister of Crown Investments Corporation appointed a ministerial advisory committee known as the Saskatchewan Rate Review Panel.

WHEREAS that Minister's Order provides for specific terms of reference for particular Crown corporation rate change reviews to be attached by further minister's order.

WHEREAS it is desirable to establish terms of reference for a SaskEnergy gas consumption rate change review and to attach the terms of reference to the previously mentioned Minister's Order.

NOW THEREFORE I hereby amend the said Minister's Order by attaching Appendix A affixed hereto as **"Schedule E: SaskEnergy Gas Consumption Rate Change Terms of Reference"** to the said Minister's Order.

Dated at the City of Regina, Saskatchewan, this 1st day of May, 2001.

Minister of Crown Investments Corporation

APPENDIX A

Schedule E:
SaskEnergy Gas Consumption Rate Change Terms of Reference

Terms of Reference

The Saskatchewan Rate Review Panel is requested to conduct a review of SaskEnergy's request for an increase in its gas consumption rates for the term June 1, 2001, to October 31, 2002.

The Panel shall provide an opinion of the fairness and reasonableness of SaskEnergy's proposed rate changes, considering the interests of the customer, the Crown corporation and the public.

In conducting its review, the Panel will consider the following factors:

The reasonableness of the proposed changes to the gas consumption rates in the context of:

1. SaskEnergy's anticipated cost of gas for the effective term;
2. the Gas Purchase Contracts entered into by SaskEnergy for the supply of gas;
3. the amounts SaskEnergy pays for the transportation of gas;
4. the natural gas commodity market conditions at the time of SaskEnergy's contractual commitments; and
5. the disposition of the balance of the Gas Cost Variance Account.

In conducting its review, the Panel shall consider the following as given:

(i) the current operating rate structure;
(ii) the approved capital allocation, annual rate of return target, rate base, and corporate policies;
(iii) the existing service level; and
(iv) the cost of service methodology and resulting study, which allocates SaskEnergy costs between the various rate classes.

The Panel will not publicly release or require SaskEnergy to publicly release commercially sensitive material including, but not limited to, its gas price hedging strategy and any details of its hedging or the gas purchase contracts.

However, the Panel may release the net effect of SaskEnergy's gas price hedging and gas purchase contracts.

Conduct of Review

The Panel will present its report to the Minister of Crown Investments Corporation no later than June 1, 2001.

Schedule "A"

Services Provided by BCUC

1. Provide professional expertise, advice and services to the Panel pertaining to a review of SaskEnergy's requests for an increase in gas consumption charges and delivery service rates.

2. Prepare and deliver to the Chair of the Panel a report on SaskEnergy's requests for an increase in gas consumption charges. The report should:

   - review whether SaskEnergy's proposed rate changes are fair and reasonable;
   - provide a recommendation to the Panel regarding SaskEnergy's rate proposals; and
   - provide a recommendation to the Panel regarding the disposition of the Gas Cost Variance Account.

3. Attend meetings as required by the Chair of the Panel.

THE BRITISH COLUMBIA UTILITIES COMMISSION STAFF

General

The British Columbia Utilities Commission is an independent regulatory agency of the Provincial Government operating under and administering the Utilities Commission Act. The Commission's primary responsibility is the regulation of the 20 energy utilities and pipelines under its jurisdiction to ensure that the rates charged for energy are fair, just and reasonable, and that utility operations provide safe, adequate and secure service to their customers. The Commission approves the construction of new facilities planned by utilities and their issuance of securities. The Commission's function is quasi-judicial and its decisions and orders may be appealed only to the Court of Appeal on questions of law or jurisdiction. The Commission members are appointed for specific terms by the Cabinet, through the Lieutenant Governor-in-Council.

The Commission's professional staff are hired independently by the Commission under the powers of the Utilities Commission Act and are separate from the Public Service Act. Commission staff provide technical advice and administration support to the Commission in all areas including engineering, finance and accounting, economics and rate design, and review of commodity contracts. Bill Grant is the Executive Director of the Commission and the most senior staff position, reporting directly to the Chairperson. Brian Williston is the Manager, Engineering and Commodity Markets and is responsible for the review of natural gas and electricity supply contracting practices and of applications for major facility additions. James Fraser is the Manager, Strategic Services and is responsible for the review of utility load forecasts, return on equity and capital structure matters, and rate design applications. Philip Nakoneshny is Senior Financial Analyst, reporting to the Manager, Rates and Finance, who is responsible for the review of revenue requirements applications. Biographies are attached.

Revenue Requirements Application Review

In British Columbia, the Utilities Commission Act provides that the only rates a public utility can lawfully charge and the only terms and conditions of service that it can apply, are those which have been filed with and accepted by the Commission. Rates must strike a balance between being a fair charge for the service provided to the customer, while permitting the utility to earn a reasonable return on its investments required to provide these services.

A revenue requirements application generally compares, for a future test period such as the next year, a forecast of the revenue generated using current rates to a forecast of the utility's cost of providing service.

The utility usually requests adjustments to customer rates to eliminate any forecast revenue deficiency or surplus. Utility costs such as operating, maintenance and administration expenses, depreciation charges, interest charges, income and other taxes, and a fair return on its equity investment, are typically recovered in fixed Monthly Charges and variable Delivery Charges. Costs related to the gas commodity are flowed-through to customers without any mark-up by the utility, and are recovered in variable Gas Consumption Charges.

Rate design is the allocation of the utility's revenue requirement to individual rate classes of customers, and the structuring of the components of rates for each class. Rate design is generally reviewed less frequently than revenue requirements. Between rate design reviews, the Commission makes revenue requirement adjustments to rates in a manner that is consistent with the rate structure and specific directions that were approved in the last rate design proceeding.

A revenue requirement application for changes to delivery rates generally requires a public hearing. Because of the adversarial nature of the traditional public hearing process, hearings can become long and costly. The Commission has introduced the following approaches in an effort to reduce costs and save time:

Negotiated Settlement Process ("NSP")

NSP has been very successful by eliminating the need for a hearing on many applications and reducing the scope of matters that need to be reviewed in other cases. In the negotiation process, individuals representing various interests openly explore issues set out in the utility's application, with the purpose of reaching common understanding of the underlying interests. Recommended solutions and agreements are arrived at through collaboration and consensus. Trade-offs between competing objectives are encouraged so that the final settlement maximizes the overall needs of the participants. Commission staff are active participants to ensure that all ratepayers are represented. Settlements are subject to Commission approval.

Performance Based Regulation ("PBR")

PBR mechanisms are used to streamline rate setting, and to implement incentives to utilities to trim costs while maintaining high quality service. A PBR mechanism typically sets a baseline revenue requirement by expense category that can be modified for inflation, productivity and other factors in the future. Both customers and shareholders are rewarded for management measures that result in costs below the baseline. Costs, like taxes, that are beyond the control of the utility are recovered at cost. Quality control measures ensure that the utility does not pursue costs savings at the expense of system reliability, safety and

customer satisfaction. PBR arrangements typically run for several years, with annual meetings to review progress and performance.

Other Processes

The Commission frequently uses workshops, pre-hearing conferences and town hall meetings as part of the hearing process. Workshops are educational sessions prior to a hearing, so that all parties have a similar level of understanding. Pre-hearing conferences optimize the hearing schedule, and attempt to identify non-contentious issues that may be removed from the scope of the hearing. Town hall meetings are less formal hearing sessions that are held at times, and in locations, which are more convenient for members of the public likely to be affected by the application.

Rather than an oral public hearing, the Commission sometimes uses a written hearing where the subject is technical and if limited interest to the public, or an Inquiry by a single Commissioner where the issue is fairly well defined and localized.

Generic Hearings

Where issues are common to several utilities, the Commission reviews the matter in a single generic hearing. This approach has been used to determine the appropriate rate of return on equity for the major utilities it regulates, and to develop a mechanism for calculating the return for future years.

Energy Supply Contract Review

In British Columbia, Section 71 of the Utilities Commission Act provides that the Commission must review and accept the commodity contracts entered into by each utility. The Commission must determine that the quantity of natural gas contracted for, and its availability, are sufficient for the needs of the core customers of the utility. The Commission must also determine that the prices in those contracts are competitive. In practice, Commission staff have an ongoing dialogue with the natural gas supply departments of the affected utilities to agree on a contracting plan early in each year and the Commission then accepts individual contracts that are consistent with the contracting plan. The utilities enter into a portfolio of natural gas contracts, including baseload contracts, peaking contracts, seasonal contracts, and underground storage contracts. BC Gas Utility Ltd. ("BC Gas") also stores gas in its liquified natural gas facility. The various contracts will include both variable priced and fixed priced contracts, along with a price risk management program to attempt to obtain the lowest overall price for the customers.

British Columbia is not blessed with underground storage nearby the primary load centre in the Lower Mainland. This circumstance, coupled with the poor load factor of the residential and commercial customers which make up the bulk of the utility core sales, results in contracting plans which are more diverse than may be necessary for a utility with local storage options.

In British Columbia each gas utility is permitted to flow-through its actual cost of gas purchases to customers. Each utility has a gas cost reconciliation account to record the difference between the actual cost of gas purchases and the revenues recovered through the gas commodity component of rates. Positive or negative balances in the account are passed through to customers in future rates. In specific instances, the Commission has approved phased-in commodity cost increases to avoid rate shock to customers. While this process has had the advantage of smoothing the rate increases to customers, it has been criticized as blunting the market signals to customers.

In response to the increase in gas prices in 2000, the Commission reviewed BC Gas Utility Ltd.'s, ("BC Gas") practices related to the setting of gas commodity rates and management of gas cost reconciliation account balances. Commission Letter No. L-5-01, dated February 5, 2001, established "Guidelines for Setting Gas Recovery Rates and Managing the Gas Cost Reconciliation Account Balance". BC Gas is to file quarterly reports on gas costs and gas commodity revenue, and to apply for a rate change if forecast costs and revenues for the next 12 months differed by more than 5 percent. The Commission did not change the three year amortization of the BC Gas gas cost reconciliation account balance at the end of 2000, but found that future amounts accumulated in the account should be amortized over 12 months in normal circumstances. Letter No. L-5-01 stated that the Guidelines would also be appropriate for other gas utilities in British Columbia.

WILLIAM JOHN GRANT, B.SC. (Eng.), MBA, CFA

Bill has been employed by the British Columbia Utilities Commission and its predecessor, the British Columbia Energy Commission, for more than 20 years. For the past 12 years he has been the Executive Director of the Commission. Prior to Commission employment he worked for Transport Canada and the Institute of Guided Ground Transport.

Bill has initiated or been involved in the development of many energy regulatory reforms including the following:

- Natural gas commodity competition and unbundling of utility tariffs. British Columbia was the first province to allow industrial customers to purchase gas directly from producers or marketers. The process of unbundling utility costs lead the Commission to initiate a bypass methodology which has been adopted by many jurisdictions;

- An automatic return on equity adjustment mechanism was first implemented in Canada by the Commission;

- The Commission has been using and refining its multi-year, performance-based rate making process over the past five years;

- The Commission has selectively used alternative dispute resolution techniques for more than ten years. Most utility rate and rate design applications are settled rather than going to public hearing; and

- The Commission first implemented wholesale electricity competition in 1996 and the first retail access application was approved in 1999.

Bill completed a Masters of Business Administration degree immediately following his undergraduate Bachelor of Science degree. He has been a Professional Engineer in Ontario and British Columbia and he returned to academic study to obtain a Chartered Financial Analyst designation from the University of Virginia. Bill enjoys skiing and mountain biking. He does not enjoy revenue requirements hearings.

JOHN BRIAN WILLISTON, P.Eng.

CAREER EXPERIENCE

British Columbia Utilities Commission

1997-00 Manager, Engineering and Commodity Markets
- Manage the engineering and energy commodity markets staff which support the regulation of natural gas and electrical utilities in British Columbia.

1992-97 Senior Petroleum Engineer
- Provided engineering support for the financial regulation of gas utilities and oil pipelines, with responsibility for energy supply contracts and market-based gas sales activities.

Williston Energy Management

1992 Principal
- Analyzed gas supplies available in British Columbia, and developed alternatives for connection of new supply areas to markets.

Canwest Gas Supply Inc.

1990-91 Vice President Operations and Transportation
- Responsible for ordering gas purchases and transporting gas marketed by the significant gas aggregator in British Columbia, including negotiating transportation contracts for deliveries throughout western North America.

British Columbia Petroleum Corporation

1989-90 Vice President Gas Supply
- Responsible for purchasing and transporting natural gas and marketing sulphur and liquid byproducts, including negotiation of new supply and service contracts.

1975-88 Chief Engineer, Senior Engineer
- Managed the engineering group, with responsibility for testing and forecasting of gas deliverability and production; economic evaluations and negotiations for new supply areas; and administration of gas purchase contracts. Earlier, evaluated feasibility of a grassroots oil refinery and petrochemical facility, and was Metric Coordinator for company.

Gulf Oil Canada Ltd.

1969-75 Process Engineer, Planning Analyst
- Provided technical support for oil refinery operations, designed and brought into service new and expanded facilitates. Optimized crude runs and operations to meet product demands.

EDUCATION, PROFESSIONAL ASSOCIATIONS

- B.Sc. in Chemical Engineering, University of New Brunswick, 1969
- Registered Professional Engineer in British Columbia
- Member of Society of Petroleum Engineers